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LAW OFFICES
FRITZ R. KAHN, P.C.
EIGHTH FLOOR
1920 N STREET, N.W.
WASHINGTON, D.C. 20036-1601
(202) 263-4152
FAX (202) 331-8330
e-mail: xiccgc@worldnet.att.net

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VIA HAND DELIVERY - RETURN COPY

Hon. Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW (7th fl.)
Washington, DC 20423-0001

Dear Secretary Williams:

Enclosed for filing in STB Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures, are the original and twenty-five copies of the Rebuttal Comments of Texas Crushed Stone Company and Georgetown Railroad Company (TCS-2).

Also enclosed is a dikette with the text of the filing in WordPerfect format.

Additional copies off this letter and of the Rebuttal Comments are enclosed for you to stamp to acknowledge your receipt of them and to return to me via the messenger.

If you have any question concerning this filing which you believe I may be able to answer or if I otherwise can be of assistance, please let me know.

Sincerely yours,

Fritz R. Kahn

enc.
cc: Mr. William B. Snead

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ORIGINAL

TCS-2

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, DC

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS
OF
TEXAS CRUSHED STONE COMPANY
and GEORGETOWN RAILROAD COMPANY

Fritz R. Kahn
Fritz R. Kahn, P. C.
1920 N Street, NW (8th fl.)
Washington, DC 20036-1601
Tel.: (202) 263-4152

Attorney for

TEXAS CRUSHED STONE COMPANY
and GEORGETOWN RAILROAD COMPANY

Due and dated: January 11, 2001

BEFORE THE
SURFACE TRANSPORTATION BOARD
WASHINGTON, D.C.

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS OF TEXAS CRUSHED STONE COMPANY and GEORGETOWN RAILROAD COMPANY

Texas Crushed Stone Company ("TCS") and Georgetown Railroad Company ("GRR"), pursuant to the Notice of Proposed Rulemaking, served October 3, 2000, rebut the railroads' Reply Comments, filed December 18, 2000, as follows:

A.

Introduction

The Association of American Railroads ("AAR") and its Class I railroad members in their Reply Comments failed altogether to respond to the Comments of TCS and GRR. AAR, The Burlington Northern and Santa Fe Railway Company ("BNSF"), The Kansas City Southern Railway Company ("KCS"), Norfolk Southern Railway Company ("NS"), Canadian National Railway Company ("CN") and Canadian Pacific Railway Company ("CP") did not even mention the Comments of TCS and GRR, and, while CSX Transportation, Inc. ("CSXT"), and Union Pacific Railroad Company ("UP") at least referred to them, neither of the railroads addressed the merits of the proposals which TCS and GRR had made or the efficacy of the conditions they had recommended be attached to the Board's approval of future major railroad mergers or acquisitions.

In their Reply Comments, the railroads, thus, do not dispute, as TCS and GRR had urged in their Comments, that Proposed §1180.1(c): Public interest considerations, requires revision to take into account the interests of the stockholders of the merging or acquiring railroad and the effect of the transactions upon value of their investments in the enterprises. Similarly, the railroads did not question that the same paragraph needs to amended to have the rate reductions, if any, made possible by the alleged efficiency gains of the merger or acquisition be a further factor to be considered by the Board in determining whether the proposed transaction is in the public interest. So, too, the railroads in their Reply Comments did not challenge the contention of TCS and GRR that the effect of the proposed transaction upon the merged or controlled and controlling railroad's ability to attract shippers, gain traffic, enlarge employment opportunities and improve the marketing opportunities of suppliers of railroad equipment and materials all should be taken into account in determining whether the merger or acquisition is consistent with the public interest.

The railroads in their Reply Comments neglected to note that one of the asserted failings of the Board's proposed regulations, namely their lack of specificity, creating "great uncertainly because it is unclear what would suffice to pass Board muster,"[1] had been found objectionable as well by TCS and GRR. TCS and GRR, however, did not merely criticize the Board for not having come up with rules of greater precision; in their Comments TCS and GRR proposed regulations that are clear, certain and concise, as we shall discuss hereinafter.

The railroads in their Reply Comments, moreover, contended that any conditions imposed by the Board when approving a future major railroad merger or acquisition must relate to the evidence of record in the proceeding, that conditions, if any, be imposed on a case-by-case basis.[2] The need for tailoring conditions to the evidence of record in a particular proceeding had been anticipated by TCS and GRR and satisfied by the conditions they recommended for adoption in their Comments. The conditions proposed by TCS and GRR are designed to be fact specific, as we shall discuss hereinafter.

B.

The railroads disagree with
the basic premise of the NPR.

Of all of the railroads, only UP appears to have grasped the Board's concerns, prompting it to undertake the revision of its regulations governing major railroad mergers or acquisitions. At page 8 of its Reply Comments, UP acknowledged:

> The important public policy questions in the next

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[1] AAR, p. 7. See, also, BNSF, pp. 15, 19; CSXT, p. 28; KCS, pp. 5, 11.

[2] See, i.e., AAR, pp. 2, 4; BNSF, pp. 7, 10; NS, pp. 7, 18.

> major Class I merger proceeding will focus on whether a North American Railroad duopoly is in the public interest. The Board will chose between a future in which two huge transcontinental systems develop single line services in isolation from each other and a future in which all remaining railroads strive to develop more efficient service over remaining interline routes. This is an important choice that can be made only once, because mergers are likely to be permanent.

Nevertheless, UP joined AAR and its Class I railroad members in trashing the Board's basic belief that whether the applicants' proposal will enhance rail-to-rail or intramodal competition needs to be a factor to be taken into consideration by the Board in determining whether a major railroad merger or acquisition is consistent with the public interest and that the Board's conditioning power is broad enough to permit it to impose requirements for enhancing competition if that were necessary to render the proposed transaction one warranting the Board's approval.[3]

The railroads maintain that the Board's espousal of enhanced rail-to-rail or intramodal competition is unprecedented, and unquestionably it is that. The Board itself acknowledged in its NPR, "Our proposed revisions . . . represent a paradigm shift in our review of major mergers." The situation in which the Board finds itself, however, is no less unprecedented. The merger regulations are not being revised as if the year were 1980 and there continued to be no fewer than 23 Class I railroads, as the railroads' Reply Comments seem to suggest. The proposed revision

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[3] See, i.e., AAR, p. 4, BNSF, pp. 17, 24; CN, p. 5; CP, p. 8; CSXT, pp. 11, 14; KCS, p. 5; NS, pp. 7, 21; UP, p. 12.

of the Board's merger regulations comes at a time when there are only two major U.S. railroads in the East, and two in the West, and, as the UP correctly noted, the next round of mergers is likely to result in two huge transcontinental railroad systems. The Board would have been derelict in the duty it owes the public if, given that situation, it had not reexamined its statutory authority and the need for modifying its major railroad merger rules. That the result of the Board's NPR process may be the promulgation of merger rules that are without precedent is of no moment, just so long as the Board explained the reasons for the regulatory changes it is adopting. As the Supreme Court said in American Trucking v. A., T. & S. F. R. Co., 387 U.S. 397, 416 (1967):

> Regulatory agencies do not establish rules of conduct to last forever; they are supposed, within the limits of the law and of fair and prudent administration, to adapt their rules and practices to the Nation's needs in a volatile, changing economy. They are neither required nor supposed to regulate the present and the future within the inflexible limits of yesterday.

As opposed as they are to the very idea that rail-to-rail or intramodal competitive enhancement should be a factor which the Board may consider in determining whether a proposed railroad merger or acquisition is consistent with the public interest and to the imposition of conditions designed to enhance competition, AAR and its Class I member railroads in their Reply Comments are careful not to contend that such actions by the Board would exceed its statutory authority, under 49 U.S.C. 11323, et seq. The railroads term the proposed rule changes the "wrong approach,"[4] contrary to "sound regulatory policy;"[5] the railroads, however, do not maintain that the Board's regulatory revisions are *ultra vires*. The railroads' silence is eloquent testimony to the broad powers with which the Board has been entrusted in passing on proposed railroad mergers and acquisitions.

The AAR and its Class I member railroads, however, do maintain that the imposition by the Board of what they term "mandatory, non-remedial conditions" would be tantamount to "reregulation" of the industry.[6] Indeed the specter of industry reregulation is portrayed as the dreaded consequence of the Board's NPR that pervades the railroads' Reply Comments, repeated throughout their submissions. Although TCS and GRR disagree that the conditions they have proposed would reregulate the industry, the railroads seem to forget that, although they have been substantially deregulated, they remain a regulated industry. Indeed, the next round of major railroad mergers or acquisitions would not be possible but for the authority of the Board to approve the proposed transactions as consistent with the public interest notwithstanding their obvious violation of the antitrust laws. The railroads note that future mergers or acquisitions likely to be undertaken by the major railroads will be end-to-end combinations heretofore found by the Board "not [to] result in

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[4] UP, p. 12.

[5] BNSF, p. 21.

[6] See, i.e., AAR, pp. 2, 4; BNSF, pp. 9, 21: CSXT, 7, 31; NS, pp. 17, 21.

competitive harm,"[7] or to "be harmful to the public interest."[8] The railroads conveniently overlook that, notwithstanding the Board's prior decisions to the contrary, vertical mergers or affiliations may be as anticompetitive as horizontal ones.[9] Moreover, but for the shelter from the antitrust laws that the Board's regulation affords, the next major Class I merger proceeding would not survive the application of the Herfindahl-Hirschman Index, by which proposed mergers in unregulated industries are tested under section 7 of the Clayton Act.[10]

Indeed, as TCS and GRR stated in their Comments, the further consolidation of the industry which the next round of major railroad mergers or acquisitions would occasion in and of itself is likely to revive certain regulation. The two trends, consolidation of the industry, on the one hand, and, on the other, its substantial deregulation, are antagonistic. If the Nation is going to be served by only two or even one major railroad, some measure of supervision of rates and services is almost certain to be reenacted.

Reregulation of the industry, the railroads maintain, would mean the end of their ability to differentially price their services, which, they contend, is essential if they are to

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[7] CSXT, p. 34.

[8] CP, p. 3.

[9] See, Ford Motor Co. v. United States, 405 U.S. 562, 570 (1972); Brown Shoe Company v. United States, 370 U.S. 294, 323-24 (1962).

[10] 15 U.S.C. 18.

survive financially.[11] Again, the railroads conveniently overlook that differential pricing has always been part of their rate structure; in the past it simply was called making rates according to what the traffic will bear.[12] The railroads differentially priced their services when pervasively regulated; they assuredly can do so when they are minimally regulated, as they would be even if the rules revisions recommended by TCS and GRR were adopted by the Board.

In sum, the railroads' Reply Comments' assault upon the Board's effort to attach a far more significant role to the enhancement of rail-to-rail or intramodal competition falls short of its mark. Indeed, as TCS and GRR asserted in their Comments — as did most commenting shippers and short line and regional railroads — the Board did not go nearly far enough.

C.

There is a need for strengthening the relationships between Class I and short line railroads.

Of all of the railroads, KCS, at pages 6-7 of its Reply Comments, was most outspoken of the need for protecting the interests of short line and regional railroads in the Board's revision of the major railroad merger rules:

> As a raft of parties have made clear in this proceeding, shortline and regional railroads are the lifeblood for a host of small communities and shippers

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11 See, i.e., BNSF, p. 15; NS, p. 19-20.

12 See, Wyman, Railroad Rate Regulation (2d ed.), §432, p. 370 (1915); Goodman, The Process of Ratemaking, part 15, p. 885, et seq. (1998).

> across the nation. Despite facing very significant obstacles to success (including operation and marketing restrictions, old physical plant in most cases, difficult financing, and occasional indifference from Class I connections), smaller railroads find way to thrive in markets less important to larger railroads. Shortlines and regional railroads, like many shippers, are occasionally caught in the fallout of failed merger planning, and are often left without meaningful recourse when their service deteriorates due to faulty Class I connections. These concerns have spurred a very significant number of parties to urge the Board to take greater measure of the fate of smaller railroads when reviewing major merger applications. Any new merger regulations must, thus, further the interests of shortline and regional railroads, to assure that they remain a viable competitive element of the transportation network.[13]

Central to the relief sought by the short line and regional railroads is the removal by the applicants to a major railroad merger or acquisition of the so-called paper or steel barriers, that is, the restrictions in their line purchase or lease agreements prohibiting or penalizing the interchange of traffic with competing railroads. As TCS and GRR contended in their Comments, echoing the position of the Association of Short Line and Regional Railroads ("ASLRRA"), "Contractual barriers affecting Class II and Class III railroads that connect with the merged or consolidated and consolidating carriers that prohibit or disadvantage full interchange rights, competitive routes and/or rates must be immediately removed by the carriers, and none imposed in the future."

The railroad, not surprisingly, oppose the removal of the paper or steel barriers. "[A]brogation [of contractual

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[13] See, also, AAR, p. 16; BNSF, 36; CSXT, p. 47; NS, p. 46.

provisions] would be inappropriate and unfair, and very likely would work an unconstitutional taking of property," said NS at page 48 of its Reply Comments. CSXT, at page 46 of its Reply Comments, termed such actions to be "contrary to the [Staggers Act] and the policies it embraces."

The railroads are poorly positioned to argue that the abrogation of contracts as part of a proposed merger or acquisition is illegal. The railroads consistently have favored the imposition of the cram-down provision of 49 U.S.C. 11321 to nullify any labor-management agreements which in their view may impede implementation of the approved transaction.[14] Indeed, the railroads are far too late to be serious in contending that the terms of private agreements may intrude upon the Board's ability to exercise the authority statutorily conferred upon it.[15] Paper or steel barriers serve no useful purpose in line sales or lease agreements other than to insulate the disposing Class I railroad from the potential competition of another carrier,[16] and at a time when the Board is concerned about preserving and even enhancing rail-to-rail or intramodal competition, the Board should condition its approval of any major railroad merger or

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[14] Norfolk & Western Ry. Co. v. American Train Dispatchers Ass'n, 49 U.S. 117 (1991).

[15] See, i.e., Maislin Industries v. Primary Steel, 497 U.S. 116, 127-28 (1990); Thompson v. Texas Mexican R. Co., 328 U.S. 134, 142-43 (1946); Missouri Pac. R. Co. Abandonment, 324 I.C.C. 357, 366 (1965).

[16] See, Kahn, "Tied Railroad Routings," 64 J. Transp. L. Logist. & Pol'y 150 (Winter 1997)

acquisition by ordering such offending provisions stricken. Such a provision would be clear and concise and be related to the facts of a particular proceeding.

TCS and GRR in their Comments, again expressing their agreement with ASLRRA, declared, "The merged or consolidated and consolidating carriers must maintain competitive joint rates through existing gateways." NS in its Reply Comments conceded the need for maintaining "major efficient gateways," as some of the other railroads did as well.[17] Nevertheless, NS was opposed to the imposition of DT&I or similar conditions, contending that "the *DT&I* conditions . . . nearly bankrupted the railroad industry."[18] As much as has been written about the demise of the Penn Central Transportation Company, The Milwaukee Road and The Rock Island, none of the observers attributed the railroads' failures to the DT&I conditions.[19] It well may be that NS does not understand how the DT&I conditions work; UP, however, had it right when, at page 14 of its Reply Comments, it said:

> Keeping a gateway open merely preserves the status quo. For example, in a hypothetical NS-BNSF merger, the condition would require NS to continue to exchange traffic at St. Louis with UP and Gateway Western, as well as with its merger partner BNSF. BNSF would maintain service with CSX as well as NS. UP, Gateway Western, and CSX wold continue to exchange traffic with

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[17] See, BNSF, p. 25; CSXT, p. 38.

[18] NS, p. 25.

[19] The Penn Central and Other Railroads, a Report to the Senate Committee on Commerce, 92d Cong., 2d Sess. (1972); Saunders, The Railroad Mergers and the Coming of Conrail (1978); Wilner, Railroad Mergers — History Analysis Insight (1997).

> the merged carriers, NS and BNSF. The merged entity would suffer no disadvantage from continuing to do what it does today.

Of course, if it makes sense to keep major gateways open, as some of the railroads concede, it would seem to make no less sense that all gateways be kept open by the merged or controlled or controlling railroads. The railroads thereby in no way would be impeded it operating through trains or otherwise passing along to their shippers the service advantages of single-line service, as some of them have contended.[20] TCS and GRR, accordingly, renew their request that the Board adopt a rule that would in effect provide that the merged or consolidated and consolidating carriers must maintain competitive joint rates through existing gateways. Such a rule would be precise and consonant with the facts adduced in the merger or acquisition proceeding

TCS and GRR in their Comments, moreover, maintained that "Class II and Class III railroads should be free to interchange with all other carriers in a terminal area without pricing or operational disadvantage." Again, it was KCS which, at pages 8-9 of its Reply Comments, was the most outspoken of all the railroads in acknowledging the need for safeguarding that actual or potential rail-to-rail or intramodal competition not be lost as a result of a major railroad merger or acquisition:

> Merger applicants should be charged with the responsibility of providing viable alternative rail service for any shippers losing such service in a merger. In this matter, the Board should do more than merely preserve competition at 2-to-1 points, as it has

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[20] See, i.e., BNSF, p. 26.

> traditionally done. Instead, all competitive options should continue to exist in a post-merger environment.[21]

The rule which TCS and GRR, as well as ASLRRA, proposed for adoption by the Board in revising its major railroad merger rules was designed to afford a short line or regional railroad served only by a merged or controlled and controlling railroad access to a second carrier within essentially the same switching district or terminal area. Such very limited competitive access, TCS and GRR insist, is essential if rail-to-rail or intramodal competition were to be enhanced, as the Board in its NPR insisted was one of its goals in revising its major railroad merger rules. Such a rule would be precise and fact specific.

TCS and GRR deems it unnecessary to repeat what other conditions they recommended the Board attach to its approval of major railroad mergers or acquisitions in the interest of preserving the competitive capabilities and economic vitality of the short line and regional railroads; they respectfully refer the Board to their Comments in which the text of the proposed conditions are set out.

D.

Conclusion

The railroads in their Reply Comments failed meaningfully to address the views expressed and the conditions proposed by TCS and GRR in their Comments. The railroads, accordingly, failed to

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[21] KCS, p. 8. See, also, BNSF, pp. 10-11; NS, p. 24; CP, pp. 10-11; UP, pp. 18-19.

recognize that the proposed conditions had the specificity and allowed for their case-by-case application, the lack of which were the principal criticisms which the railroads leveled at the Board's proposed competitive enhancing conditions. The conditions proposed by TCS and GRR are modest and reasonable, and they warrant adoption by the Board.

Respectfully submitted,

TEXAS CRUSHED STONE COMPANY
GEORGETOWN RAILROAD COMPANY

By their attorney,

Fritz R. Kahn
Fritz R. Kahn, P.C.
1920 N Street, NW (8th fl.)
Washington, DC 20036-1601
Tel.: (202) 263-4152

Due and dated: January 11, 2001

CERTIFICATE OF SERVICE

I certify that I this day have served copies of the foregoing Rebuttal Comments upon counsel for each of the parties by mailing them copies thereof, with first-class postage prepaid.

Dated at Washington, DC, this 11th day of January 2001.

Fritz R. Kahn